

## **Rail Service Competition Council**

### **Meeting #1**

**EB:** Hi, I am Evan Barrett with the Governors Office of Economic Development. I am going to temporarily chair this meeting and at one spot here relatively soon we will select a chair and Vice chair for the board. But welcome to all who are observing the proceeding and all members of the council. This is extremely important work that we are beginning to engage upon. This was brought home to us all last week, Friday when the Gov and several of us accompanied the vice chairman of the surface transportation board to meeting with agricultural producers in Big Sandy and Scobey. And the wonderful articulation of the problems faced by those producers faced with very uncompetitive rail rates that are perhaps the highest in the nation and perhaps the most profitable leg of BN service in the nation, those captive shippers stories were told extraordinarily well to the surface transportation board and they are indicative of other captive shippers with other commodities. So the Legislature in creating the body has created an entity that we hope can make a real difference in terms of eliminating by various means the situation with rail rates in Montana, which are very noncompetitive and harmful to the economy of this state. So thank you for joining us. I would like at this particular point to ask to go around the table and have everybody introduce themselves and a little about their background. I would call to your attention the second and third page behind the agenda is a list of the council members. Why don't we go to my left here and start with Larry.

**LB:** I am Larry Bonderud I am representing the port of northern Montana in Shelby that's the inland port authority and has a great relationship with the port of Montana in Butte. WE deal with a lot of tucking and rail issues Shelby of course is located at the east west north south crossing of the BN rail road so we have had a lot of years of working with and on the rail road, so I guess that is why I am here.

**EB:** Larry is technically in here as someone with knowledge of the trucking industry, which he certainly has.

**CA:** Good morning my name is Carla Allen I am the general manager of Central Montana Rail in Denton and I have been with the rail road for 20 years, general manager of 15 years, and I am here representing the small railroads, the class 2 and class 3, and I have some first hand knowledge of the problems we have.

**SKH:** I'm Senator Ken Hansen and I serve senate district 17 and I guess I was appointed here for the economic council. I farm and ranch, a little history on my background, actually I think I work for the banker more than I farm and ranch. I am in my second term in the Montana state senate. This is a very interesting committee for me and I am very pleased to be on it and serve it with you.

**MO:** I am Mike O'Hara from Fort Benton, and on the personal side I farm and ranch in north central Montana. I guess I am one of the captive shippers here, predominantly we

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raise winter wheat on our place and we have a couple of small elevators in Fort Benton that are really interested to see how this works out.

**EB:** Mike is technically here for his knowledge of farm commodity shipping, which he obviously has direct relationship to.

**RH:** I am Russ Hobbs with Plum Creek Timber; I am the lumber marketing manager and the traffic department reports to me. I am here for the experience on the lumber business, as you know PC is the largest private land owner in the State of Montana and probably the largest wood products producer. I think that that is the expertise that I am bringing to the table, and we are also a captive shipper.

**DB:** I am Dan Bucks the director of revenue. I am here I think for two reasons, number one is to be resource for the role that taxation plays in the cost structure of the various industries that are relevant to this, certainly the railroad industry and any competitive sources of transportation. Secondly because of the work we do on taxation in terms of property valuation and other taxation of the enterprises we develop expertise in the general financial condition of the business or corporations involved. While in some cases it is public information and in some cases it is confidential information, the department of revenue has the knowledge that come with working regularly in taxation with respect to the enterprises that are involved, that are the subject of this council.

**DM:** Doug Miller with Revett Silver Co, been in the hard rock mining industry for 30 years and most of our concentrate is shipped by rail to smelters out of the country or quite a ways away from this area. I guess that my knowledge is of the rail shipping of our commodity also.

**RTM:** Tom McGillvray I represent house district 50 in Billings Montana and I am appointed from the economic affairs interim committee to represent that committee. I am excited to be here, it is one of the committees I didn't mind being appointed to, I was kind of excited about it. My father worked on the railroad his entire life, and I worked on the Milwaukee railroad for three summers while I was going through college so it is kind of an interesting committee to be a part of and I am looking forward to helping out.

**BF:** I am Bill Fogarty the former general manager for the port of Montana at Butte. We worked with Union Pacific and BN we worked a lot with our good friends in Shelby. Prior to that I was administrator of the transportation..... I retired from the port about a year ago but stayed active with the local development corporation. It is a pleasure to be here and I am representing the, for my knowledge the Class 1 railroads.

**NP:** Nancy Peterson director of Montana department of Agriculture, producer, farm and ranch my whole life. I can identify with Senator Hansen said about meeting with the banker. I took 24 hours off and made a quick trip home and took my 84 year old mother out to dinner on Sunday night but spent Monday with the banker and I am not sure if it was trick or treating on whose part. But delighted to be here and as Evan stated that the

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meeting we had last Friday with producer in the field was I think just an awesome opportunity for folk to really relay to the folk, the surface transportation board in particular, from DC the issues that their decisions affect our lives every day. It is a hot issue a hard issue and one that affects all of us in the industry.

**JL:** My name is Jim Lynch I'm the director of the Montana department of Transportation and it has county down there as Lewis and Clark but I represent all the counties in Montana. Some of you may know or may not know that rail falls under the umbrella of the Department of Transportation and the DOT has been involved in quite a few situations involving freight rates both for agricultural purposes and non ag purposes and rail abandonment and additions so I am excited to lend my expertise to this committee. I have spent, before being the director, about 30 years extensively in the construction business dealing with highway construction and also the operation of truck fleets on our highways. So I have a little bit of experience in the transportation field.

**EB:** Thanks to all of you. A little bit of quick house keeping. We are recording the proceeding so as most of the Legislators know if you want to speak grab one of these and put it in front of you. It helps on everyone in the room to hear and works well on the recording, but be forewarned, you can't really whisper and think that It is not being recorded because it is. Now we are also wanted to and whenever Mary Jo can get down here, and you don't have to rush her down. An explanation of travel and expenses basically I think we treat the legislator slightly differently. I think that there is travel mileage per diem for the time that you are away from home and the cost of the motel room or whatever. She will come down and explain that and give you forms that you can fill out so that you can get reimbursed for the cost of serving here. And I think that there is a slightly different formula for legislators but we will leave that up to her to explain or go over with you. If you need any help with that Mary Joe Murray in our office is the person to contact and talk to. Also we are not really used to being running boards so this was assigned to the Gov Office so those of you who are out there I recognize that we haven't made material available. So feel free to contact Adam who is sitting here at the end and he will get you any and all of the materials and I am going to ask you him to get you a copy of the agenda. Do you all have agendas? We will have him get a copy of the agenda for you okay so you can follow the proceeding and then the additional material we will make available afterwards. Adam I wonder if you could also make some additional copies of the agenda so they can follow the meeting. Now let me quickly go through how we got to be here and then at a certain point I will turn this over and we will get a chair and vice chair designated. In your packet the first thing you see under that list are two versions of senate bill 315, one is the final text version the other is the PDF version that shows the way it went through the legislature with line number and the amendments and everything. Senate bill 315b was passed in the 2003 session sponsored by Senator Trudy Schmitt as the prime sponsor. The purpose of that bill was to authorize the administration to proceed to conduct a through analysis of the rail competition issue as much as they could and present a report to the 2005 legislature. In doing so if you look on page 2 section 1 it say feasibility study and rail freight competition. The office of economic development will present a report. That report by the way you all have a copy

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of, that is this report we sent it to you electronically before but this is a hard copy. You see a. impacts on Montana from rail freight competition or lack of competition. They really were supposed to look at whether or not businesses have been turned away from Montana for lack of good competition. That was one element of that study that wasn't pursued vigorously. Benchmarks for a comparison of freight rates and competition, analysis the benefits of competition, the potential for public and private investment to improve it, proposals to improve it, analysis of the cost and benefits of state owned infrastructure compared to private infrastructure and so on. So that was passed in 2003 and in the interim the RL Banks and Associates was contracted to do this study and it was produced in late October, just before the session was convened and right before the election. So we have that as kind of an interesting, essential bit of information for us all. As a result of that study the next thing you will see in your packet is house bill 769, this was sponsored by Rep. George Golie and you will see Senator Hansen and Senator Schmidt listed on this bill and this particular bill was a follow up saying that now that we have seen the study, and there is a series of recommendations in this study, that the legislature then directed the creation of a council to deal with those issues. Now the council according to the statute has no termination date, this is a permanent board, council. Now it was not perfectly drafted in that it didn't have things like terms and things that like that that are normally in there. We will have to go back into the next legislature and do a little house keeping on those issues. In house bill 769 it started with George Golie because it included an appropriation and it was introduced late in the session and therefore it had a start in the house. But Senator Schmidt was on the bill and she was a prime pusher along with Rep Golie for the bill. It lays out as you can see who would be on this council, all of you, by description. Then if you are looking at the numbered bill and go to page to, essentially between lines 4 and 21 are the duties of the council, and we will talk about them during section 8 on the agenda. Then if you go to the back of the bill you will see that there is an appropriation of \$50,000 per year out of Director Lynches highway revenue account, and we are very appreciative.

**JL:** You're welcome

**EB:** And so we will go into exactly what, but that is enough money to conduct meetings, but more important than that there is probably enough money here for us to retain some contracted services some skilled folks who can come in and help us with particular chores or research that we may need to have done to advance certain things. And then I wanted to mention two other bills, but I am going to hold off on that because Carol is here and she is going to help us with what we do with expenses. Carol Smith from our office.

Carol Smith: I am Carol Smith and I will be paying travel expenses. We pay travel expenses for councils through the states vendor payment system, so I need to make sure that everyone is in there. So first fill out a W9 form, name, social security number, current address, and then sign it. Then I can get you in the vendor system if you are not already in there. This is a state travel claim; you need to fill these out. Fill out the date and time that you left and time you returned, this determines your meal allowance. If you had to stay in a Motel then I need the actual motel receipt, I can not work off of a credit

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card statement. That is true of any incidental expenses. You need to sign it at the bottom.

**EB:** There is a mileage thing to right?

Carol Smith: I need your round trip mileage and you are paid 44.5 cents per mile

**EB:** So before you leave today if you would fill those out it is the best way to do it, make sure, we will turn them into Carol and if she sees any problems she will give you a call and make sure it is all clarified. Now we have two legislators on there are they treated differently in terms of is there an extra recompense for that or something?

Carol Smith: If they are claiming legislative pay for the day then I turn that over to legislative services and they will pay it, but if it is just travel expenses then it is just normal state travel.

**EB:** Can we check with the legislative council on that issue

**Carol Smith:** I will check on that

**EB:** Thank you. Let me also mention to you cause these are part of the bills that are stacked here for you are HB 512 which is by Rep. Witt. 512 was taken care of in the 2005 session and what it does is appropriate \$1.1 to the department for use during the biennium. What this is, is money that was loaned out to the development of a grain terminal in Butte 20 years ago which created a competitive alternative to grain shipping in Montana. For those of you that weren't around then, even though no grain is grow in Butte/Silver Bow, the location where Union Pacific comes into Montana created an alternative so that, it is not uncommon for North Dakota trucks to come down to Butte and ship there grain out of Butte. Within 90 days of the opening of that port BNSF reduced its contract rates across the entire state. Bill Ewer with transportation bureau at that point saw that happen. Then within a year we saw their tariffs reduced. So that 1.1 was a 0% balloon payment loan made to stimulate the development of that port that shows that the state took a proactive role at that time. That is being repaid in January and it goes into a revolving loan fund, isn't that right Dick. So this bill, 512, simply appropriates it so that it can be put to use. Also, I don't know that this is in the pack it order, is the pack in order, the second bill, it should be in order. House bill 757, Lou Jones was the primary sponsor of that bill, and that bill established an essential rail freight act and a revolving loan account and provided for the issuance of revenue bonds to fund that account. So we are going to have to as we delve further into this if there is, for rehab of existing spurs, building new lines if necessary. There are funding mechanisms in terms of this revolving loan fund and sources of revenue which we will talk about later. But I wanted to call those to your attention and definitely we also provided a packet of reading materials for you. I wanted to go through those quickly for you. One was just a white paper that was put together, that is worth looking at for the Governor and all of us to review prior to the office of service transportation board last

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week. There is a Montana rail overview done as well which gives a general overview, a USDA analysis in long term trends in rail railroad service and capacity for agriculture. Several of the current suits that are in front of the Surface Transportation Board, the Alliance for Rail Competition has brought one and I believe there are two of them here that are related to the Staggers Act and its impacts. And I thought we had somewhere in this packet, a little bit lower. Did we have Terry's comments on this? They are stuck inside the booklet. This is a critique of the study that was written by Terry Whiteside who we considered to be a very friendly expert who is nationally known for his capabilities in rail competition. It just gives a little flavor of things, it is good to look at the back page of that analysis first where he summarizes it and then go back and see what he did. But this is a very good study over all and it has accomplished getting us where we are today. Now to the council organizational issues, there where no terms listed in the statute so we are assuming that individuals will serve 2 year terms. And then we will go back to the legislature and clarify the language and get into some revolving terms. Secondly virtually all the statutes call for the Governor to designate a chairman of a president of the board and officers. That did not happen in this case, it wasn't referenced there. So we will talk about the election of the chair and vice chair in just one second. Thirdly, on administration, the statute place the administration of the council in our office, so Adam de Yong who is here at the end will be handling routine administration activity on behalf of the council. So he is your contact person and his direct line is 444-5514. So again that is Adam de Yong. He is one of our economic development specialists. Now if I can get to the election of our chair and vice chair. Now I don't want to lay a heavy hand on this thing, it doesn't say the Governor would appoint a chair, but the Governor has expressed to us a preference on who he would like to chair this thing. Now he didn't want any of us who are legislators of department heads or working in the administration to chair this thing. He thought that it should be members of the citizenry who represent these various interests. His preference was to have Mike O'Hara to be the chair and have Carla Allen to be the vice chair. Both of them are very much involved in real shipping issues. He felt some comfort level with that. So I would open it up to the committee to see want to proceed in any different manner of if you feel comfort in that we could just proceed with a motion.

I move that we accept those as chair and vice chair.

I second that motion

**EB:** Well we had a motion and a second here, is there any discussion on that motion. All those in favor say I

**All council members: I**

**EB:** All those appose say Nay

**EB:** The I's have it, Mike would you like to come up here and I will move to the side. I will be trying to help out a lot in this first meeting just from an organizational

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perspective. Carla would you like to move up here as well. These are the places where the chair and the vice chair get to sit.

**MO:** Well thank you Evan and I would like to thank everyone on the board that um for I think confidence and we will try to proceed in a timely manner and hopefully we will get everyone out of here before it is too late. I think we have a presentation from Dick Turner on rail competition issues and so I guess we will let you take the floor.

**JL:** Mr. Chairmen was Dick introduced prior to me showing up here

**EB:** Yes he was, not by title, perhaps

**JL:** Dick is the bureau chief for MDOT dealing with rail and transit issues, he has considerable knowledge on the history of rail issues as it was given to the DOT in 1991, is that correct, when it came over from commerce to the DOT. So he is a great resource for any committee members here on rail issues and some of the history of it, and I think that he is going to talk about that today. He has been a great help to me dealing with issues dealing with rail. In my absence I have asked Dick to represent me, because I think that you are going to want to use his expertise anyway.

**MO:** Alright Jim, Dick before you get started I would like the people in the back of the room to introduce yourself so we know who all is here.

**Bob Raney:** I am a public service commissioner

**Spook Stang:** I am executive vice president of the MT Motor Carrier Division

**Mark Cole:** I am a principle in a trucking a trucking firm out of Shelby, I am also a board member of the MT mining association, MT Agribusiness association, MT Motor carrier association, so far

**Richard Owen:** Executive Vice president of the Montana Grain Grower Association in Great Falls

**MO:** Okay, thank you for coming and I look forward to hearing your input. Dick

**Dick Turner:** Thanks Mr. Chairmen. Evan asked me to give another presentation of the same presentation that Terry Whiteside and I gave last Friday in Big Sandy and Scobey. Obviously for those presentations Terry Whiteside was with us and able to give his part of the presentation. I will try to do his part of the presentation justice since he is not here today. My part of the presentation was the first part, I talked about Montana rail infrastructure history and then Terry talked about the rate issues and then some of the national competitive issues. And Jim we do not have it on power point.

**JL:** Oh you are not going to put it on power point; I distracted everybody for no reason.

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**DT:** This is the third time I have given this presentation in the last 5 days so it will get better and better. Since I don't believe that Mr. Buttery has ever been out to Montana before, he is the vice chair of the STB, I tried to give him a geography lesson about Montana and just how large a state Montana is and how that is relative to our reliance on rail transportation. Slide two tries to put the size of Montana into perspective with the 10 North Eastern states. As you can see the 10 states fit within the boundary of Montana. Not only that the 10 NE States have almost 50 million people and of course Montana has less than a million. Road Island has more people than Montana by 200 thousand people. We also developed a map that shows the distance from Helena to Scobey is further than the distance from Washington DC to Cleveland. The bottom line is that Montana is a huge state with a low population, does not have huge internal market, we have a lot of raw commodities that have to go long distances to make it to market. And that means rail transportation. Slide number 5 on page three show the Montana rail system 50 years ago when we had 6 class one railroads, then 25 years ago following the merger that created the Burlington Northern railroad and the bankruptcy of Milwaukee Road. We only had 3 class 1 railroads and that is essentially the way it is today, with some essential differences. The only two other class one railroads that still serve Montana today are the UP up to port of Montana, where bill used to work and the CP rail via the little short line railroad that comes in in the very North Eastern part of the state North of Plentywood. CP rail leases that to DMVW to provide grain shipping service to the whitetail elevator. If you move to slide number seven on page 4 this is the rail system today, and I do have color copies of this map that I will hand out. This is very similar to the rail system 25 years ago, with the important difference that we have lost quite a few branch lines, the line between FT Benton and Big Sandy, Seco to Oakland, Glendive to Circle which was abandoned this year, mostly grain shipping lines. The next map on slide 8 still on page 4 shows another major infrastructure development that has just occurred in the last 10 years, and that is the construction of the 110 car shuttle loading facilities around the state, there are 11 of these facilities. The circles on the map indicate the approximate service area for the shuttle loading facilities, and this is based on a study done by North Dakota several years ago. Obviously that isn't a hard line around those areas, but an approximate area of influence. The important thing is to look at the number of existing branch lines and smaller elevators within those circles. We are already seeing that the small elevators and branch lines are feeling the effect of those facilities. So on slide nine page five I summarized where we are at today with Montana's rail system, we have lost nearly 2000 miles of rail since 1975, BNSF is the dominant class 1 railroad in Montana. 94% of our rail system, there is no other state in the country that has class one railroad service that has that percent, or nearly that percent of its system controlled by one class 1 railroad. I think Delaware has 83% and that is the next highest. 91% of tons hauled, 92% of revenue, some of the major developing trends, increase short lining of BNSF lines, more potential for abandonment's, traffic has decreased on short lines which usually leads to abandonment, decreased intermodal facilities, which Larry Bonderud and Mark Cole are very familiar with. BNSF closed its intermodal facility at Shelby earlier this year and that leaves one intermodal facility in Montana, and that is at Billings. Also increased impact of the shuttle facilities, which I had mentioned before, and we are still seeing impacts form those. The rest of the presentation is Terry's presentation and he starts with talking

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about the state of the class 1 system nationally. Obviously to a large degree we are not alone here in Montana, as mergers have occurred here over the years. There are just four class one railroads in the US. He included on slide 12 page 6, a map that shows the systems of those four railroads. Terry of course focused, due to the nature of the on meetings Agricultural issues. He made the point that rail producers pay the cost of freight; essentially they are price takers and thus cannot pass the cost of freight onto anyone else. He underlines that point on slide 15. Terry had a very popular slide, page 8 slide 16 that got a lot of interest. He dug up a 1935 edition of a very popular board game that stated that if you owned all 4 railroads that you could charge 8 times the rates, and the name of the game was Monopoly. Then Terry got into very interesting graphs based on his analysis of rates from Montana shipping points compared to areas that have rail to rail competition. Slide 20 on page 10 show the dramatic difference in those rates between areas that have competitive options in rail service compared to locations in Montana. That dotted line across the graph that says "STB threshold of unreasonableness" is the 180% level that STB say is an appropriate level of return for railroads. So obviously, on this graph, the Montana shipping points are above that. The next slide, top of page 11, looks at some other similar shipping points, rate per mile, rail rate comparisons, same story. Then at the top of page 12 he compares the single car rates, again you can see there is quite a fluctuation, again these occur where there is no competition, again you can see these are above that 180% rate of return level. Again bottom of page 12, multicar rates, you see a similar story. Slide 25, Terry rapped up by summarizing the reason for these high rates, and Terry believes, as most people believe, it is the lack of rail competition. He also made the point that even though Montana shippers are captive shippers, or customers, these shippers want healthy railroads and good rail service. It is not that the shippers are against the railroads they are just against the railroads charging more to ship there product than is really justified.

**EB:** Mr. Chairman

**MO:** Yes Evan

**EB:** I wonder could you check outside and see if the food is out there? I thought I might, Dick has had to be a little cautious in his language because he is paid with federal funds, so if I could just run back through a couple of things here, points that are worth noting. On page 4 where we show the 110 car loading facilities. The key thing that I think we all know is happening there is that the price pressure is being put on where BN is essentially telling the grain folks, pricing the grain delivery in such a manner that you can't afford to take you grain to a facility that handles 52 cars

End Tape Side 1

**EB:** On the West coast in ports that can not handle 110 car shuttles, they have to break them up out on the West coast. So it isn't required by the people on the West Coast. It is being used as an anticompetitive device here that, now in addition to that, if we go to page, it is a couple of points about.

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**DB:** Evan, now when you say anticompetitive device, do you mean, who owns the 110 car facilities

**EB:** They are owned by private entities who have put those up at the behest of the BN with kind of a commitment that that is where the grain is going to go, leaving those that put up 52 car loading facilities 15 years ago at the same behest, out to dry. So one of the interesting things we noted and the Governor made a point of at the meetings last week, there were no grain terminal operator there to talk about the problem because they have got to get along with BN to survive. Only the producers were there to talk about the problem, but the people they take the stuff to, whether the 52 car facilities or the 110 were not there. Essentially BN is forcing to fewer and fewer spots under the name of efficiency, and it probably is more efficient for them, but it is more costly to the producers and it endangers the competitive smaller grain terminals and in turn endangers the smaller competitive branch lines.

**NP:** Mr. Chair, Evan if I might just add to that not only providing the incentives for prices, so on and so forth, 6 cents more, 6 cents less, and Carla can speak to this better than I, BNSF has put hard fast dollars into those facilities and the circles that they need to run the 110 car loaders. So the incentive in terms of price and also the incentive to the elevator to do such a thing is there, dollars up front, to the tune of 2 to 3 million in some cases.

**BF:** Another side of this has been my experience, is that the same companies own the facilities on the branch lines. So we may want to take a look at that too, but local personal definitely want to hold on to those facilities and their jobs. I know the two that operate out of FT Benton have other shuttle facilities, so there is a conflict of interest there within those companies with where they are going to put their emphasis.

**Dick Turner:** Mr. Chairman the most dramatic example of that is the Big Sandy elevator is owned by the same company that has a shuttle facility 30 or 40 miles away

**NP:** ADM

**LB:** We participate in the development of the 110 facility there at Shelby, we helped facilitate that. The driving factor behind all this is the BNSF moved 25% more grain last year with 25% less rail cars and so the whole big picture in this is the economies it allows the railroad to have in equipment and equipment utilization. In theory it should affect the rate down the road, but that is what we haven't realized. I remember years ago looking at the map of 52 car unit facilities and where they were going to be and how many there were going to be and what impact that was going to have on the little little facilities. We ended up with a lot more 52 car facilities than anyone anticipated. I just thought that out for information for folks because there is a history of this. It is kind of like the railroad upping the anti again, saying okay we went to the 52's now we are going to the 110's.

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**DB:** I guess I just, we I don't want to get ahead of the game, but you hit on the issue which is perhaps we are moving 25% more grain with 25% fewer cars meaning greater efficiency, but who benefits from the efficiency. The question is, is that spread to the grain growers as well as to the industry? Who gets to slice the efficiency pie, or how the pie is sliced?

**EB:** Mr. Chair, if I may. Just to continue briefly, start with page 10, where we start with those bar charts. The STB is required to accomplish 2 objectives with rail and freight in the US; one is to provide for the health of the railroads, to provide for a healthy rail system, so that we are not losing major railroads. The other is to in the process of providing a healthy rail system to make sure that those who are captured shippers are taken care of. That is the crux of the problem in Montana. Nobody wants unhealthy railroads. We want to make sure that when we are the ultimate captive shipper group in the nation. If you look at the bar chart you see that dotted line is roughly at the 150% of variable cost, which is the amount that is a reasonable rate, according to the STB. If you look at all the subsequent ones you can see that all these other states are generally below 150, but Montana, no matter what mode of transportation being used is way above that, in fact it is about 300% of variable cost. Almost twice as much as on the top chart on 11, if you go to the top chart on page 12 you'll see on the single car rate in Montana and North Dakota are the highest. That is where it hits 400-450%. Then if you look at the Montana North Dakota and South Dakota multicar rates get about 500% of variable cost, when 150 is the rate deemed to be an adequate level. That is an example of what we are talking about. There are a couple of things in the back of your packet which are recent news articles that speak to the profitability of the railroad. One is a Gazette article, October 30, which speaks about the hearings that were held last week, official gets earful on BNSF service. That is about the hearings that were last week. October 27 that says BNSF makes record profit off demand. Which speaks about their profits being at record levels now, and they are busy. That is the main reason they are making money hand over fist but they are just making a disproportionate amount out of Montana. The last one is the September 25<sup>th</sup> article, Imports and efficiencies bring profits to railroads. Down at the last paragraph of that it says under the subheading of higher rate, so strong is the demand for rail service that railroads can do something that airlines can only dream of, impose higher rates. They are in a supply demand issue right now and the higher rates are being imposed and in that process our shippers and producers are being hurt. There is a lot to this but those are some of the key things that Terry and Dick presented and I think it is useful to look at those. Are the sandwiches out there? Not yet, okay. Mr. Chair.

**MO:** We might as well move on to item 8 on your agenda. We will get started there and when lunch arrives we will partake. We will start with the discussion of the council's roles. Actually these are outlined on HB 769 of what our role is, anyway, we will start with "Promote Competition" Any comments?

**NP:** If I might say, that in the UP in particular, I guess, is an issue, and there are talks and discussions out there with Watco in particular with specific to certain areas in the state. And we can tell by the color map that DOT put together, and Dick has done a great

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job here, with those spur lines that all connect to BNSF in particular. But with the UP and the connection, and someone brought it up earlier about the producers. I had a producer on the phone this morning who he himself trucked grain from the golden triangle to the port of Montana and was able to capture 5 to 6 cents more that route than going on the BNSF route to Portland, prior to fuel price increases. But I think that the Great Falls to Helena line, and we talk about promoting competition, it's about saving some of those opportunities that we have to connect in particular that are absolutely crucial to what happens with transportation issue in the state. I am sure that Bill has some concerns and issues along those lines, but I just wanted to bring that one up in particular. Again, while we are thankful that Watco is willing to take on some those issues, it is a grave issue. Dick if I might something just struck me that I had not questioned before. In the shuttle loading facilities, the 110 the 11, 12 is split with Havre with ADM, and Cenex Harvest States, but that one circle eastern Montana with Macon and Wolf Point, any idea why that circle overlaps more than any of the other 10 within the state. So what prompted a shuttle shuttle side by side?

**Dick Turner:** Mr. Chair, Nancy, I don't know, actually that has been a frustration for the department. These large grain loading facilities will be constructed and basically the department doesn't know that they are even planned until we drive by and see them being constructed. The vast majority of them are not even on the state highway system, they are on county roads. There are a couple however that are on the state system, that new one at Wolf point is, and we have had some dealings in working with how to safely access that off of highway two. I would assume, obviously those are two different companies; I would assume that it was a competitive decision and that both those companies believe that there is enough business within those circles to justify those facilities. I have heard it said that if they are starting from scratch that it is 4 or 5 million dollars to build these shuttle facilities. Larry Bonderud may have a better idea based on his experience in Shelby.

**LB:** Ya know it I going to get worse we see the CP doing 160 car trains, and that is a 3 mile train. The Shelby facility was built 1500 feet, 3 miles, and they are looking at some of those trains. So it is just a real interesting thing to look at. Cenex Harvest States granted in the major player in these across Montana and various relationships and partnerships they have developed, certainly with the blessing of the BNSF who uses various methods and means to contribute to the financial viability of these facilities. So where they go and things of this nature is kind of driven by the private sector per se, everyone of them has a business plan and everyone of them says that they are going to be successful, much like the 52 car facilities did.

**MO:** WE don't want to monopolize the discussion on grain, if mining or timber has anything to add to this please step in.

**LB:** You bring that up and I will bring another thing to the table here. It is the intermodal; it is what Mr. Turner talked about. The other aspect of this that effects the economy of Montana, I believe and we are certainly aware of is the lack of intermodal

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facilities in Montana. One only in Billings now, the lack of ability to load and ocean container anywhere in Montana on a regularly scheduled basis. I think to our value added concepts, mining, and lumber all of these are really going to be, as we add value to those products, and try to create more jobs here it is a key missing element in our rail system is the intermodal and multimodal systems and the ocean container. We have dealt with this issue for year wit the folk at the Port of Montana in Butte. It is a real issue, the UP doesn't do it and here you have competition, they could do it, but the UP doesn't seem to have the willingness to aggressively pursue that as well as BNSF. The criterion threshold that they put in place to activate those facilities. They closed the Shelby facilities with Kansas City and Sacramento California, so we had good company. It just talks about the threshold and part of it is the same issue, the million in population. Part of it is driven by what you can bring into Montana to make those containers available so that we have something to put in them to move out. We travel all over Montana and see the containers moving up and down the road and wonder where are they at and where they came from and what are they doing here, and that is something else that because of lack of competition they don't have to do it.

**MO:** One thing that was pointed out at that meeting in Big Sandy was that the fastest growing freight that the railroad is experiencing right now is the intermodal transportation systems so if Montana can't capitalize on that for a lot of reasons then. I know that we have a small flower mill in Ft Benton that does specialty wheat and loosing the intermodal facility in Shelby, I haven't talked with management there in with what they are doing, but I know that it had a real effect. They have 11 employees there, and in a small town like that it is a big deal. They have got to change their business plan or come up with another way to have this identity preserved containers.

**SKH:** I think that one of the things with intermodal that is kind of a problem is that it is probably one of the least profitable operations on the railroad. I know with UP that they had a lot of intermodal service, but what they geared a lot of their traffic to is the expedited trains. One of their biggest customers is UPS or these kind of people, so if you are trying to feed them say at Pocatello with 8 or 10 container for them to stop an expedited train that basically has a block of 100 containers that are going to the same location. It doesn't work very well for them, and they are not going to put that traffic in jeopardy to do that. That is one of the issues we had, but I guess conversely to that when BN was doing the intermodal containers at Silver Bow we had about 70 to 100 containers a month that were going out of there, then they doubled their container rates. When that happened we talked to them and to a lot of their customers out of there, Talc was a big one, and they just didn't care. So what happened, it ended up being trucked down by Likes who operates a terminal in Salt Lake City and it goes on the UP, but BN didn't care. So what are you going to do on a situation like that?

**CA:** I have just attended a short line conference in Dallas Ft Worth and one of the first things they told us was that 90% of their business, and that BNSF, would be containerized within the next ten years. They are talking about intermodal facilities in major metropolitan areas.

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**SKH:** And higher value commodities to. When you are trying to put buck wheat of grain or something like that in there then you are really up against the cost squeeze, but if you get a higher value commodity in there then it is a different issue. It is like GM and the auto cars, with the high value commodity the profits are good and they will do things to make it work.

**EB:** Mr. Chairman, just a comment on the competition issue, Nancy brought up UP, and we have that down below to discuss. When we think about the loss, Terry and I were talking the other day, and we do not all go back quite to remember the demise of the Milwaukee in the mid 70 up until about 1980 when it was gone, totally gone. It is a tragic loss for the state of Montana, and there is an axiom in economic development which is if you have core infrastructure do not give it up. If you have paved highways would you give them up? When we were faced with the tearing down of the concentrator at the Butte mines, once that concentrator was torn down it would never be rebuilt, it would be way to expensive to do that. We could never afford to have them tear up the interstates and put them back. The loss of rail, key economic infrastructure like rail, when that is pulled up and gone you can never replace it. What you get is trails for bikers, or the right of way split off between the land owners. But would we be in the same situation we are today had the State of Montana had mirrored the effort of South Dakota and acquired the right of way and the rail of the Milwaukee, probably not. Now that is water under the bridge, we can not do anything about that. But the message is there for the future, what ever we have in rail infrastructure in Montana, whether it is the line between Great Falls and Helena, the UP coming up into Butte, the branch lines that exist. It is just against the rules of economic success to think about ever having them taken up. That is part of the mission, I believe as the person who represents economic development at this table, part of the mission of this council is to see that those mistakes are not replicated again. Lunch is here.

**MO:** Well, let's recess and grab some lunch.

**DB:** It would be very interesting to have a national map, because I am learning very interesting things about where are lumber is going. Which is not to Portland, where the grain is going, they are going to California, Arizona, and the industrial Midwest where and North East where lots of houses are built. Where the coal and other products of mining are going may be another location. One question is where stuff is coming from? At a future meeting I would be interested in seeing where are product is going. Our grain am I correct Nancy, goes to Portland and Minneapolis. But what proportion goes where and where the dividing point is would be of interest as well. So what is going where, in what quantities is a big picture background item for us to think about. I don't know if there is any immediate conclusion. Many of you already have experience in this area, and probably already know where this stuff goes, some of us don't know that.

**MO:** Richard, would you share a little information on where are grain goes in the State of Montana.

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Richard Owen: In the case of grain it is kind of a 90, 10 rule. 90% will head across our state to Portland.

**MO:** What about lumber?

**RH:** What I was explaining with lumber is that most of our product is going to head east bound to the Midwest, Chicago is a major destination for us, Minneapolis. We also service, and so will the mills around Missoula, all along the South Western part of the state are going to do a lot of business in California, and Salt Lake, Boise, and those markets. Texas is also a very large market, for structural framing lumber. So we are going on the highline in both directions and then heading south through Pasco, is one of the ways we will end up getting to those south western markets. And I would say the more than half of that is going east bound.

**MO:** Anything to share on the mining end?

**DM:** Well our concentrate is dependant on smelters, and there are not many smelters left in the country. So most of the concentrate is shipped out of the country, our concentrate right now is going to Timmons Ontario, but you know Asia is eating up a lot of copper concentrate, it goes to China and Japan. So a fair amount of it goes to Vancouver and then barge to Japan or china. There are a few who send concentrates down to Arizona, there are a few smelters still operating there.

**EB:** What is your knowledge of where MR sends their copper concentrate now?

**DM:** Arizona

**EB:** Arizona, mostly, and then the talc and those industrial minerals.

**BF:** Some of it was going to China for a while, I think they switch over a little bit, but I think most of it goes to Arizona.

**DB:** What about the Coal?

**EB:** Dan you said you were on the coal board?

**SKH:** Mr. Chairman I guess I would like to get this on the record to but, I went to the meeting in Big Sandy and I also went to the meeting they had, I believe it was a year ago, also in Big Sandy. I will tell you from the grain aspect of it, the producers frustration, they see from BNSF, law makers, and probably this committee, nothing but lip service. That came up a number of times this last meeting. The other thing they asked repeatedly is to really look outside the box, don't get zeroed in on primary problems that we do have, but tot look out from everything from the organic grain growers. I served on a committee that went to Canada here a few months ago about cattle coming in to the US, and I will also tell you that the producers up there have the same problem we have. So

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we need to look outside and come with something that will be beneficial to the mining and the, I really appreciate hearing all that because I guess I am not that familiar with lumber, and the mining and that type of thing, and when you boil right down to it we have the same problems.

**MO:** One of the things that came up at the Big Sandy meeting, there was a gentleman there from Rocky Boy, think it must have been the economic development, sounds like they are really going forward with plans for a sizeable ethanol plant. If that short line is closed the business plan fails, and the finances go and everything else. It refers back to Evans comments on economic development, we don't want to let go of any of our infrastructure if at all possible. There is a one that is immediate, and I don't know, but they could probably lose it on the rumor that it is going to be abandoned

**NP:** News just in, BNSF's fuel surcharge for December 18.5%, they are currently at 16%.

**CA:** Is everybody aware that BN did file for abandonment for on the Lewistown line.

**Dick Turner:** They filed their environmental analysis and they have said that they will file the official abandonment on or after the 17<sup>th</sup>, is I think the way that they worded it. It is coming though.

**MO:** At the Big Sandy meeting, back to the surcharge issue, Dick was it you that brought up their income statement from BN and their additional fuel costs for a time period, and I can't remember if it was a fiscal year, was 40 some million dollars, but the revenue from the surcharge was nearly 3 times what the increased cost was in diesel. So they have turned their surcharge into a very nice profit center for the railroad, but it looks like they are not quite satisfied yet.

**CA:** when I was I Dallas Fort Worth the fuel surcharge was the hot topic for this particular conference, they are going to try to implement their fuel surcharge, and they want to attach that to car hire for their branch lines and that most of the branch lines are paid, not a division of revenue, they are paid a flat fee. Our particular rate is tied to the r-stat, it is a means of computing the revenue for the year, but it specifically excludes fuel. So when we get a rate adjustment it doesn't include fuel. So they want to tie fuel to our car hire, which they call and NR agreement, we all have dwell times or free times, and they want to attach it to that. If they want to come in and renegotiate our contracts and if you have 96 hours free time and they want you to bring it under that they will review that on a quarterly basis and if you do not meet that quota they want to reduce our rate by 25%, and so on and so on. It leads to more efficiency for them supposedly, but I haven't figured out what it does for us.

**MO:** Evan

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**EB:** Mr. Chairman, relative to what Senator Hansen's mentioned about the frustration of folks who have seen everyone have a lot of concern about this and we all have a lot of angst about it. We complain about the situation, and yet the feeling is that little gets done and that, I would like to suggest at least that the council thinks in big terms. Not to initially start out being marginalized by the circumstance that we are in, but seeing those circumstances as an opportunity to be bold, visionary, to see things that maybe, maybe they can't get done right now, but if they could get done would make a big difference. The maintenance of the UP line up to Butte is a number one essential. We need to make sure that that stays in the competitive hands. The Up has talked about finding ways to sell it, and we have to make sure that the railroad that purchases it maintains the competitive posture of the line. If you look at the line for Garrison into Butte on this map, it is a gateway controlled by BN, many years that was Montana Western, but it was recently re-acquired by BN so that for example MRL wanted to run stuff from Livingston on out through butte and on south they have to do it through a bunch of interlining agreement and stuff. They have to get by the 48 miles that are a gateway of control by BN. That particular gateway represents an opportunity, as does the line from Shelby; you have a BN line from Shelby up to Sweet grass there. For example, if we were to envision building a railroad from Shelby up to connect with Canadian Pacific, to be owned by a port authority or somebody. We have tools at our disposal as a state to potentially do something like that, if it makes economic sense. It can't just be something that will just crater out. If the flow of business is there, if even after the reaction of BN to lower rates to dry up the traffic on a line like that, you have to consider that in the financial analysis. If there was a line from Shelby up to the Canadian Pacific, if UP was maintained, if there was a line from Garrison into Silver Bow. You are talking about southern and northern escapes to major carriers that create competition. Perhaps the idea would be if it was like the interstate, if Sweet Grass all the way down to Monida was connected. Right now we have the Great Falls to Helena that they are angling for abandonment, but if that line was just like the interstate, you could go up and down the state north and south, it kind of breaks the east west strangle hold on the state. I am not saying these are the things that need to be done, or should be done absolutely, but I think we need to have some vision and willingness to be bold. There are tools now at our disposal in terms of state resources, state bonding capacity, federal money for branch line rehab and construction. That weren't here a few years ago, and those are doors of opportunity that need to be explored, and as we move this thing forward, my thought is let's make sure we don't suffer for lack of vision, lack of ambition to do something. Essentially they won't come back in five years and say, remember that Rail Service Competition Council, well they didn't get much done either.

**MO:** I guess that would tie into the development of a rail service competition plan.

**LB:** I think another thing that the committee needs to look at and understand is the big picture outside this map of Montana and how we are affected by that. For instance, the really reason the Great Falls Helena line isn't being used isn't because part of it fell in the river, it is because BNSF railroad was granted trackage rights as a concession in the SP merger in California. They were given trackage rights on the SP down into California

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which allowed them to, previously they moved their CP interchange at Shelby, they came down to Great Falls and on to Helena and made their connect at the UP in Silver Bow and went on the UP down to California. When they were granted those trackage rights in California they immediately shifted that traffic down to Shelby, west to the coast and now down into California on the BNSF line, so now they get the long haul. During those merger discussions the State of Montana should have been at the table. Before the STB, and saying that is great that you are going to give them some trackage rights, we want some trackage rights as well. What this committee really needs to look at is to put the state in a position of knowledge to understand what is going on with railroads all around it, and how to react when opportunity presents itself, like the next merger. What should we be at the table asking for, on whose case, and who for. What role does MRL play in this, what is the real deal with MRL, whose railroad is it really, and who is running it and what can they do and what can't they do. Because that relates to some of our thought and what we are thinking about, we really need to know factually, because if BNSF turns off the switch on their bridge traffic they could be laying off a whole bunch of people, because they control them on all ends and sides, and they very wisely did that, the people that are in Ft Worth Dallas that have the weegie board for Montana for the future and stuff. They have done corporately some very smart things and also an understanding that the nation's economy, which is doing really good now, which is bad for us because that is why the trains don't want to stop is because the nation's economy is doing really well and the world economy...

End Tape 1 Side 2

**RTM:** There were some timeframes in there, remember the rate unreasonableness finally came, and they were declared that their rates were unreasonable, and they were in far in excess of the 180% of revenue adequacy, and then there was supposed to be some kind of awarded of judgment, and those were the things that kept getting drawn out.

**NP:** If I might, I am hearing lot of things happening here, and I am not just hearing filing a small rate case complaint possibly with the STB, but other issues, PSC in North Dakota is involved. So what action should this council support in terms of the North Dakota issues, not only law suits, but the PSC in particular. Besides the small rate issue here, besides abandonment, besides I mean all of those issues, it is not just a great big one piece, there are lots of smaller pieces here that we need to be cognizant of and put our heads together and see what direction and support as a council we want to do. So again I think that there is more than one avenue here, and the economic development things, the UP absolutely, the CP absolutely, the Watco, and I am not saying we necessarily support that issue financially in particular when we are not sure, well the relationship with BNSF, I will say it. So the issues and concerns we have with the STB, yeah you are right, do we have producers back home that are saying what the hell, what did we do this for, we just said it all over again, absolutely. If we don't take them to task, if we don't continue to scream, if we don't continue to fight, where are we going? So I think that there are a lot of issues here, a lot of avenues a lot of really critical areas that need attention.

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**RH:** I think one other thing we have got to keep in mind is that right now BN has said I have lots of business, so as we think about how we develop competition I think incentives are going to be something we should think about in rather than punishment, in their view, again you have a balance of their common carrier responsibilities that we can use as a lever with them, but they are doing well right now. I know as Plum Creek has pushed back with, I am going to have to convert some of this business to truck and we get, okay we are short on cars, center beam flat cars are the key movement for dimension lumber studs and boards, you know that means that I am not going to have to invest as much into those, so if you want to send it by truck, go ahead. So they are certainly feeling confident right now about their position, and the other railroads are equally busy with their networks. WE have seen into California, embargos because there is so much activity going on, you have seen it down in Houston and along the Gulf Coast there. So I think incentives are something we have got to consider as part of our quiver.

**MO:** We have one of our members who is going to have to depart, Larry is going to have to leave, he has a connection he has to make so thanks.

**LB:** Just briefly, I really look forward to working with the group, I think I am kind of known for working outside the box, Evan, so I think we can come up with some really good, constructive and positive things. And I think we bring the railroads along in this, I don't think we leave them out there, I think we engage them and let them know what is going on. The other point is, I think that the Class 1 railroads in the US are becoming more receptive to infrastructure assistance from public entities and I think that you are seeing a change in their thinking due to a lot of things, and BNSF may be receptive to some new thoughts.

**MO:** One of the things we need to get done today is the council's role. I think we have spent considerable time on competition plan, how about re-evaluation of taxation, any comments on that. These are the ones that are basically in HB 769 that we have been directed to look at these and these are what mission is.

**DB:** Mr. Chairman, if I could just make a few comments here as introduction, well first of all I will talk about just the property tax and income tax framework very briefly, but my real question to the council will be what are the questions that you all may be interested in specifically. There are a lot of different ways to look at and approach the tax system, and those of you who have looked at transportation issues may have questions in your mind that are different from the work we normally do in the department, from the standpoint of the kinds of research we do. I am here as your link to the tax system, for better or worse, and I will provide the research to try to answer your questions. It is no surprise that Montana has a tax system that relies on property taxes and income taxes. Very briefly, with regard to property taxation of railroads the dominant factor that sets our framework of that is not state law, but federal law, the 4R act. It is not one that is very satisfactory to state taxation official, and it should not be satisfactory to state legislators, because basically congress has preempted state authority on taxation of railroads, the framework of it is, the state legislature can not set a separate classification

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rate for railroads, as opposed to other commercial and industrial property in the state. The 4R act says that you must tax railroads in the same manner that you tax all other commercial property in the state. We can go through the formulas that we go through every year, if you are interested, to adjust the rate of taxation of the railroads as far as their classification rate to get from market value to taxable value, we can go through that and explain that, basically that is the concept. One of the issues in the 4R act at the time it was enacted in the 1970's, it was enacted because the railroad industry was in crisis, and quite frankly the only reason congress enacted the 4R act was to give the railroads a break, to cut their taxes. Well the railroad industry is no longer in the same shape, but they still enjoy the 4R act provisions. One of the things the rail industry swore up and down was that the 4R act would not affect the valuation process, the process of establishing the market value. Well the BN challenged that later, and in the 1980's they won a US Supreme court decision to challenge their valuations. And you say what is wrong with that, they can appeal their valuations. Well what's different is that everybody else has to appeal their valuation of property, you house, business, farm, through a system that the State Legislator has established of county tax appeal boards or state tax appeals board, on through the state court system. That is one avenue of justice for every body except the railroads, the railroads; they get to go into federal district courts. The problem with that is the Federal district courts aren't bound by the precedents and don't have the knowledge that is developed in the state court system and appeals system. I always summarize it as follows; separate justice is not equal justice. They have special justice that has proven to be favorable to them. Federal District courts are a very unfavorable venue for states because it cost a boat load of money, when you get right down to it. To try a case in federal district court and state taxing authorities don't have the money needed to get the job done in the courts. So that is the frame work that vitally effects the property taxation of railroads, and it has resulted over time in a substantial shift of property tax burden, that the legislature had established decades ago on the railroads, and shifted it to other property tax payers. I don't have the exact data, but that is the history, a history that played out in the seventies and eighties. That for contemporaries is considered ancient history. Income taxation basically the BN and the UP and the other railways in the state that are incorporated, and my bet is that they are corporations, and they are subject to the corporation license tax, and the basic rate of that tax is 6.75%. The thing that I would most note is that Montana's tax system as it affects the rail transportation system, the corporate income tax, I should say, is about average. In my judgment would not create a burden on the rail industry that would be great in relation to the kind of corporate income tax burden in other states. Now the industry may dispute that, I have never heard that argument, it has not come to my desk both in my current ten year or when I was with the department in the 1980s. My basis for saying we are about average is because our 6.75% tax rate is about average in terms of our tax rate on all corporations, not just the rail industry. That would be my two observations in terms of a general framework of taxation, as to specific questions you have Mr. Chairmen, that is really what I would be interested in knowing. What kinds of issues, and we may not have time today to do that, but that is what I would like to know because then I can put some people to work or at least tell you whether or not we have enough time or data to do the

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work. But we can at least see try to see how much we can address the questions that are of interest to all of you on the council.

**MO:** Any other comments on the taxation?

**EB:** Mr. Chair I would just like to call to everyone's attention in the RL Banks study, page 97 through the top of 101 is the narrative on taxation, it doesn't show up in the table of contents, but if you go to page 97 that number 3 continues on down to number 4 on page 101. That is a discussion of some alternative thoughts that RL Banks had, although they admit that they are not a tax expert. I would also like to raise that the charter of this commission is to, under item C, reevaluate the states railroad taxation practices to ensure reasonable competition, but I stress this, while minimizing any transfer of tax burden. It doesn't do us much good if we raise taxes on the railroad, but it simply adds to the cost in a commensurate, or even more amount to the shipper. So that becomes a delicate issue on how to handle it legislatively if we are to make some tax, if taxes were fixed in Montana perhaps as maybe they might be and it ended up costing more, that money could be channeled into rail competition issues, not just become a general fund issue. It will be a challenge to figure out how to do it and minimize the impact, or the pass through impact, which I think is something that Richard and I have talked about quite a bit, it is the fear of shippers that punitive taxation just hurts the guy doing the shipping, so we have to figure out these methodologies.

**DB:** If I could just, there are some things in here, looking at these pages, that I think, and actually what they are saying in many instances is that the taxing authorities maybe undervaluing the railroad in terms of the valuation. Keep in mind where the valuation disputes of railroads go. There is an important background point about the difference as to how a corporate income tax works for a multi state company. You have in Dick Turners, or Mr. Whiteside's work, one or the other, this information on how Montana's, the assertion that, which I accept as being valid, that the profitability of the railroad in Montana is high in relation to other locations, I think that statement appears in the power point. That is not how you calculate the profit of a company for corporate income tax purposes; you don't put a boundary around the state and see what was earned in the state, because their financial accounting books aren't kept that way. If you were to try to do it there are a lot of shenanigans that can be played, suddenly the income was earned in Wyoming, which doesn't have income tax, and not Montana. Instead what we do is use a system of apportionment, you add up the total income of the corporation and its related affiliates that are integral to the operation in Montana. You add all that profit together and then multiply it by the apportionment factor. The apportionment factor in Montana is the average of three factors, the percentage of sales in Montana versus their sales everywhere, in the case of BN their freight rate, the freight charges in Montana versus charges everywhere, their payroll in Montana versus payroll everywhere, and their property in Montana versus property everywhere, their property at historical cost, now in a railroad land grant situation that may have impact. That is the, you take the average of payroll, property, and sales fractions times the total income of the enterprise everywhere, and that then becomes Montana income, and that is then take and multiplied by 6.75%.

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My point in walking you through that, and I am commenting in particular on page 99 in the book that implies you should assess the profits specifically in the state, well that is not really feasible to do. If Montana's operations are more profitable to BN, or any other railroad, I don't want to mention just one railroad, I don't want to do that. If a railroad's operations were more profitable in Montana than elsewhere, then that just gets averaged out in this formula. It is just pooling, like wise if our profits are less in Montana by some calculations, it still just goes into the overall pool. Sorry to go into detail, but I want to make sure that if we get into these policy issues that people don't think that we calculate profits of a company on this kind of a strict geographic basis, that is not how corporate income taxes work.

**MO:** Fisher

One of the things that might be useful for the council, is director if you could go back to the department and take Bob Bergman's bill from that last session that we all supported. See what might need to be fixed, or where the gaps in that bill are.

**DB:** That was the bill that added a special apportionment factor to the railroads, that needs a legal review as well.

**MO:** We should also keep the incentive side of this in mind as well. It may help in developing short lines down the road.

**DB:** The federal law states that we can not tax differently from other commercial and industrial property in the state. Under the state constitution we can not discriminate between railroads. Congress outlawed the state legislative authority from taxing railroads differently from other commercial property.

**MO:** Okay any further discussion.

**EB:** Mr. Chair there is a pattern when one looks at it. Bad service is provided, usage declines, and then the railroad says, look no one uses it so we can abandon it, it is a self fulfilling agenda.

**MO:** Any other comments along that line? ..... Okay, then let's look at the date of our next meeting. It seems to me that we should wait till after the holidays and schedule a meeting for sometime in early January. Does that work for everyone? Location I am assuming will be in Helena..... Okay, any comments from the public?

I would like to thank everyone for their participation today. With that I would like to make a motion to adjourn.

I second that motion.

All in favor say I.....Motion passed.

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